4 February 2016

Mr Warwick Anderson
General Manager – Network Finance and Reporting
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Dear Mr Anderson

RE: ACTEWAGL REVISED ACCESSS ARRANGEMENT

Origin Energy (Origin) appreciates the opportunity to provide input to the Australian Energy Regulator's (AER) assessment of the Access Arrangement submitted by ActewAGL for the Queanbeyan and Palerang gas distribution network for the period 2016-21.

Origin has previously expressed its support for the AER's application of the Better Regulation reform package. We feel the AER's approach to assessing costs not only places greater onus on the businesses to justify their expenditures but it also delegates greater responsibility on how they manage their revenue allowances. We consider that this approach has been appropriately applied in the AER's assessment of ActewAGL's access arrangement.

In terms of the review to date, we would also acknowledge the co-operative approach adopted by ActewAGL. While we have not always agreed on issues, it has been a constructive process and we appreciate ActewAGL's approach.

In terms of its revised access arrangement, ActewAGL has not accepted in all instances many aspects of the AER's draft decision; notably the rate of return. In addition, we retain concerns previously raised with respect to aspects of ActewAGL's proposed tariffs and the tariff re-assignment process.

Origin's comments on these and other specific issues are set out below.

Weighted Average Cost of Capital

As part of its initial access arrangement submission, ActewAGL proposed using a hybrid debt management strategy to transition from an on the day approach to a trailing average approach. Origin understands that this involved: 1) the calculation of an historical trailing average debt risk premium for 10 years; 2) the average of one to 10 year swap rates during the period 2-30 January 2015; and 3) swap transaction costs.

This approach produced a cost of debt estimate of 5.34%.

In our response, we maintained our support for the AER's preferred method of a 10 year transition to a trailing average benchmark debt rate.

In its revised access arrangement, ActewAGL proposed the immediate implementation of the trailing average approach to estimate the return on debt (i.e. no transition). This results in an increase to its originally proposed cost of debt from 5.34% to 7.81%.

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We note that ActewAGL's approach of an immediate transition is consistent with Networks NSW and more recently the Victorian electricity distribution networks. We also note that the Networks NSW approach is currently subject to appeal before the Australian Competition Tribunal.

In previous submissions on this issue, Origin has referred to the Australian Energy Market Commission's (AEMC) rule determination relating to the economic regulation of network service providers (ERC0134). In that decision, the AEMC did not mandate any particular approach to estimating the return on debt. Instead, the final rule sets out at a very broad level the characteristics to estimating the return on debt that could reasonably be contemplated by a regulator. Furthermore, the AEMC intended the regulator to have the discretion to propose an approach and that this judgement is to be exercised in such a way as to be consistent with the overall allowed rate of return objective.[1]

While the AEMC delegated discretion to the AER in terms of the approach and application of a calculation of cost of debt, it nevertheless considered the issue of transitioning. Specifically, the AEMC engaged SFG Consulting (SFG) to provide advice on a range of matters associated with the regulatory rate of return. SFG concluded that the type of "rolling in" arrangement that has been proposed by Queensland Treasury Corporation would be an effective means of transitioning from the current rules to the use of an historical average cost of debt approach.[2]

SFG also noted that if the regulatory allowance was set by not allowing an appropriate transition arrangement, the result would be either a potentially material benefit or loss to the business – and conversely a potentially material loss or benefit for customers. Moreover, an appropriate transition arrangement effectively destroys any incentive or ability for a business to seek to "game" the regulatory allowance by proposing whichever method might result in the highest allowance.

We would be disappointed if the reasons behind the change in ActewAGL's approach were driven by the opportunity to access a higher rate of return should the Tribunal find in favour of Networks NSW, especially as this was not a method they originally proposed. Notwithstanding, we maintain our position that the AER has exercised its judgement to arrive at a method to estimate the cost of debt consistent with the AEMC's policy intent and we support its transition approach.

In terms of the cost of equity, during the Guideline development process, the AER explored the options of adopting a primary model, a primary model with reasonableness checks, several primary models with fixed weights or a multi-model approach.

The AER adopted the position that it must have regard to all relevant material submitted, including outcomes from the different asset pricing models (i.e. the SLCAPM, Black CAPM, FFM and DGM). When having regard to relevant evidence, the AER has undertaken to apply its judgement to determine how it can best incorporate this evidence into its return on equity estimate.

In decisions made to date, the AER has relied principally on the output of the SLCAPM. Origin has supported this approach in the past and we maintain our view that the AER has no reason to expect that adjusting the method it has adopted to date would better contribute to the achievement of the allowed rate of return objective.

[1] AEMC, Rule Determination, National Electricity Amendment (Economic Regulation of Network Service Providers) Rule, 2012, p. 90.

[2] SFG Consulting, Rule change proposals relating to the debt component of the regulated rate of return, Report for AEMC, 21 August 2012, p. 46.

For these reasons, Origin maintains its view that the AER has adopted a balanced and pragmatic approach that provides certain and predictable outcomes for investors and provides a balance between the views of consumer groups and the network businesses. We strongly encourage the AER to not accept the revised rate of return proposals put forward by ActewAGL. For further detail on our position with respect to WACC we refer the AER to our previous submissions in response to submissions lodged by the electricity distribution network businesses.

Reference Tariffs

ActewAGL has proposed a number of additional tariff categories. In particular, it has proposed the introduction of volume tariffs with higher fixed charges and lower volume rates compared to the default volume residential tariff. It argues that these tariffs are designed for customers with multiple gas appliances.

ActewAGL's proposed multi–appliance tariffs are optional. As part of the transition to the reference service agreement (RSA), all Tariff Market Customers will transition to the default residential individually metered tariff category (i.e. the existing tariff structure). To be assigned to a multi–appliance tariff category, a customer must request this through their retailer. Having a sufficiently high consumption or multiple gas appliances will not necessitate a transfer to this tariff category. ActewAGL argued that on this basis, customers will not be discriminated against because they have choice about tariff assignment.

Origin agrees that customer choice is important. We also support the intent behind the structure (i.e. declining block) of the multi-appliance tariff to encourage greater utilisation of the network. However, we maintain our position that the uptake of this tariff is dependent on the eligibility being sufficiently simple so that it can be easily communicated to and understood by residential customers.

For example, as we understand under the proposed approach a customer that has gas heating and another gas appliance may be eligible for the multi-appliance tariff and therefore access to lower usage charges. However, a customer also with gas heating but without additional appliances who uses more gas than the multi-appliance customer will not be eligible despite a higher consumption. As a result, we consider that these tariffs will be difficult to administer (e.g. how can you differentiate a customer with and without multiple appliances) and in the case of single appliance customers with high usage could perversely promote substitute energy sources rather than encouraging gas consumption.

We believe these impediments could be easily removed by setting volume thresholds for eligibility. This will provide certainty for both retailers and customers and will be easier and more cost effective to promote and administer. For these reasons, we encourage both the AER and ActewAGL to re-consider the eligibility criteria for volume tariffs and to apply clearly understood volume thresholds.

We are also concerned regarding the emergence of a growing number of tariffs and consider that given the size of ActewAGL's network there is a case for less tariffs, such as a single residential and single business tariff; which seems to work effectively in most other jurisdictions.

Tariff Re-Assignment

As part of its proposed 2016–21 access arrangement, ActewAGL proposed a RSA to replace the individually negotiated gas transport services agreements (GTAs). The introduction of the RSA will also enable the bulk transfer of customers to the revised default tariffs.

ActewAGL originally proposed to execute this agreement and to transfer default tariff customers onto the revised tariffs within two weeks after the commencement of the 2016 access arrangement.

In its Draft Decision, the AER did not accept ActewAGL's proposed timing. The AER went on to state that it encouraged ActewAGL and its users to cooperate in determining a process outside the access arrangement that is efficient and fair.

We support the AER approach of requiring affected parties to agree the terms of the transfer. However, we believe this approach must be underpinned by clearly defined resolution criteria to apply in the event that parties cannot agree on acceptable transfer terms.

If you have any questions regarding this submission please contact Sean Greenup in the first instance on (07) 3867 0620.

Yours sincerely

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